THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

NCS - Q4 2016 NCI Building Systems Inc Earnings Call

EVENT DATE/TIME: DECEMBER 09, 2016 / 2:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Darcey Matthews *NCI Building Systems, Inc. - VP of IR*

Norm Chambers *NCI Building Systems, Inc. - CEO*

Mark Johnson *NCI Building Systems, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Lee Jagoda *CJS Securities - Analyst*

Steven Fisher *UBS - Analyst*

Bob Wetenhall *RBC Capital Markets - Analyst*

Scott Schrier *Citigroup - Analyst*

Trey Grooms *Stephens Inc. - Analyst*

PRESENTATION

Operator

Greetings and welcome to the NCI Building Systems fourth-quarter earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Ms. Darcey Matthews, Vice President of IR. Thank you, Ms. Matthews, you may begin.

Darcey Matthews - *NCI Building Systems, Inc. - VP of IR*

Good morning, and thank you for your interest in NCI Building Systems. Joining me today for the call are Norm Chambers, our CEO, and Mark Johnson, our CFO.

Please be reminded that comments regarding the Company's results and projections may include forward-looking statements, which are subject to risks and uncertainties. These risks are described in detail in the Company's SEC filings, earnings release, and supplemental slide presentation. The Company's actual results may differ materially from the anticipated performance, or expressed -- results expressed or implied by these forward-looking statements.

Additionally, management will refer to certain non-GAAP financial measures. You could find a reconciliation of these non-GAAP financial measures and other related information in our earnings release and our supplemental presentation located on our website.

As you know, our fourth quarter earnings were released last night. On the call this morning Norm will provide a few strategic highlights about our recent fiscal year and a preliminary view of what we anticipate in 2017. Then he will turn the call over to Mark who will offer details regarding our fourth quarter financial performance, and our guidance for the first quarter. Finally Norm will end with some closing remarks.

After that, we'll be happy to take your questions. At this time, I'd like to turn the call over to Norm.

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Thanks, Darcey. Good morning, everyone. Today, I'd like to provide an overview of our key accomplishments for 2016, and then I'd like to share some thoughts on how we see the market developing in 2017.

For 2016, we are very pleased to have generated year-over-year improvement in revenue, gross profit margin and adjusted EBITDA. Our revenues were up 7.8%, gross profit increased 14.9%, and adjusted EBITDA increased 27.7%. Our total volume increased by 11.8%, which exceeds the expected adjusted Dodge underlying growth of 4% to 5% and was more in line with our leading indicators that we follow internally.

All three of our business segments, including the insulated metal panel products, performed very well. Our performance this year was a direct result of the structural reorganization we have implemented in our commercial, manufacturing supply chain groups. The centralization of those key functions has resulted in improved operational leverage throughout our business segments, and we see additional opportunities to drive further process improvements.

We continue to be very pleased with the double digit growth of our IMP Brands, where our backlog grew 17% on a year-over-year basis. And during 2016, our internal distribution networks in our buildings components groups enjoyed very positive growth in IMP product sales, due in part as product substitution from traditional building materials.

Over the past two years, we have generated meaningful cash flow, which we track as adjusted EBITDA, minus CapEx, and changes in working capital. In 2016 alone, we utilized over $120 million in cash flow, buying back our stock, paying down debt, and funding our capital program, all while maintaining a strong capital structure. Mark will provide additional details of these activities in his remarks.

Looking into next year's markets, we currently expect low-rise non-residential construction starts to continue to grow in the range of 3% to 6%. While it is likely that 2017 will start off weaker because of the slowdown in business activity prior to the election, since then, all of our businesses have picked up nicely. The buildings backlog for the month of November were up year-over-year by 6%, and backlog grew meaningfully, as well.

Our overriding corporate objective has been to establish a business platform that enables NCI to grow faster than the low-rise non-res market while allowing expansion of our operating margins. Through a combination of internal cost savings initiatives and the growth of our business segments, bolstered by the IMP, we are well positioned to do so.

As one of the fastest-growing building products in the country, the IMP business now represents approximately 24% of our revenue, and 31% of our EBITDA. With our distribution network and the continuing advancement of energy code requirements in the US, we expect to see continuation of double digit growth for the product during 2017 and 2018, which should enable us to continue to outperform the non-residential markets.

Our 2017 performance will be further enhanced by specific process and cost efficiency initiatives started in 2016, in both manufacturing and ESG&A. These initiatives should reduce our run rate costs by $15 million to $20 million each for a total of $30 million to $40 million in savings by the end of 2018. We expect to generate approximately $10 million of these cost savings during 2017. Mark will provide some additional details on these savings shortly.

The operational platform we've put in place over the past two years is allowing us to generate both top and bottom line growth, as well as margin expansion, on a more predictable basis, irrespective of market conditions. And when combined with the growth opportunity insulated metal panels, and our cost savings initiative, we believe our business is well-balanced with above market growth opportunities.

I would like to leave you with one additional thought. Our intent going forward is to provide a more balanced return to our shareholders, and our ability to generate free cash flow should allow us to meet that objective. We have a very good hand to play and the right structure to achieve our revenue and EBITDA goals in 2017. Now, I'll turn the call over to Mark for a review of our fourth-quarter results.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Thank you, Norm. As is customary, we have provided a review of our 2016 fourth quarter financials in both the earnings press release issued yesterday and the quarterly supplemental presentation posted on our website. I'll now take a few minutes to add some additional insight to our results.

Overall, the fourth quarter was within the range of our expectations, and in line with guidance we provided on August 31. We did experience slower than anticipated incoming order rates in the last two months of the quarter, similar to what has been reported by some of our peers and in recent commentary from the American Institute of Architects.

As a result, our revenues came closer to the lower end of our guidance than the upper end. We suspect that some of this hesitation was related to general market uncertainties leading up to the election cycle. Despite the fact that some customers were reluctant to commit to orders, we continued to see consistent strong levels of inquiries and quotings throughout the period.

While it is early yet, following the elections, we have seen some broad improvement and year-over-year growth in booking levels, particularly in the building segment. Key drivers during the fourth quarter were continued execution of our cost reduction initiatives, solid year-over-year gains in volume, and disciplined pricing across all three segments, in a period of rapidly rising input costs.

And while we had gains in volumes across our mix of products, the hesitancy I mentioned a moment ago was more quickly reflected within our legacy metal components product lines, due to the relatively short order to ship cycle time. Nonetheless, our consolidated revenue increased 4.5% year-over-year to $480.3 million, and our third-party volumes measured in tons increased approximately 3%.

While we continue to successfully implement our key cost-saving initiatives for manufacturing, we did see 170 basis point contraction in our consolidated gross margins to 25.2%, which was within the guidance range we provided. 50 basis points of this year-over-year contraction related in large part to the rapidly increasing steel input costs in this year's fourth quarter, compared to rapidly declining costs in last year's fourth quarter.

This issue is most evident in our building segment, making for a more difficult year-over-year comparison this quarter. As we have discussed in the past, steel price volatility during any given fiscal year historically has not materially affected our consolidated margins, because the margins in each of our three segments react to steel volatility in opposing directions.

However, within an individual quarter and an individual segment, it can and does cause variation. It should also be noted that we recorded a correction to the Century acquisition opening balance sheet during the fourth quarter which reduced our revenue by $1.8 million and reduced our margins by about 30 basis points. Finally, changes in product mix and the costs associated with our manufacturing reorganization accounted for the remainder of the margin contraction.

Our ESG&A expenses as a percent of revenue improved to 16.2% this year, compared to 16.6% last year. This improvement results from successful execution of our cost reduction initiatives. ESG&A expenses increased by 1.6%, or approximately $1.2 million, primarily as a result of volume-related cost increases and higher short-term and long-term incentive compensation costs, which are tied to annual financial performance achievements.

Our adjusted EBITDA was $53.7 million, essentially in line with our internal estimates. While our consolidated annual effective tax rate was 35.4%, our fourth-quarter effective tax rate was higher at 40%, due to the inclusion of higher than expected year-end annual tax provision reconciliation and true-up adjustments.

Now I'll briefly turn to our segment operating results. Once again, our components group was the largest contributor to year-over-year earnings growth this period. We saw increased volumes for our insulated metal panel products from external customer demand, and I'd like to highlight that our own internal distribution channels are generating even broader growth opportunities in IMP products.

We also successfully passed through rapidly increasing steel input costs in our pricing. All of these helped drive a 6.1% year-over-year improvement in our components revenues. ESG&A costs for the components segment benefited from cost reductions and lower amortization of acquisition-related intangible assets. Top line growth and lower costs enabled us to improve our operating margins to 10.6% in the current quarter, from 6.6% last year.

In our buildings group, total revenue was up 3.3% to $204 million, driven by a combination of improved price realization, as well as a 2% increase in total tonnage volume. Backlog in the building segment at year-end increased 3.1% year-over-year to $333.4 million. Despite higher revenues, as well as a 6% reduction in ESG&A from our cost reduction initiatives, our operating margins decreased from 12.9% in last year's fourth quarter to 11.2% in this quarter.

As I mentioned earlier, this was first brought about by our rapid increase in steel costs within this segment, compared to rapidly declining costs in the prior-year period, giving rise to a more challenging year-over-year comparison. Secondly, the continuing implementation of our manufacturing cost reductions created some transitional inefficiencies, that are negatively impacting margins in the short-term.

The coating segment saw volume increases from both internal and external demand, which drove a 9% improvement in revenues; however we did see a decrease in our operating margins, due to the fact that we are now coating our IMP requirements internally. Since this process involves smaller production runs and more complex and stringent technical specifications, the contribution margins, while still favorable, were slightly lower than average. As we build upon this capability, our processes will improve over time to address the more complex nature of these products. With our ESG&A costs remaining flat year-over-year, this resulted in operating margins declining from 11.3% in the prior year to 10.1% in the current quarter.

Now, I'll take a brief look at some items on our balance sheet. We ended the quarter with a cash balance of $65 million, and free cash flow, defined as adjusted EBITDA minus CapEx and net changes in working capital, was approximately $107 million for the quarter.

During the quarter, we used cash to continue our debt reduction plan, as well as repurchase outstanding shares of stock under our amended stock repurchase program. We paid down $10 million of long-term debt for a total reduction of $40 million for the full fiscal year. Our net debt leverage ratio at the end of the fiscal year was 2 times as compared to the 2.6 at the same time last year. We have successfully achieved and now surpassed our objective of returning our leverage ratio to the pre-acquisition level of 2.2 times. During FY16, we repurchased approximately 4.5 million shares for $62.9 million, for a net price of $13.96 per share, which is additive to shareholder value.

Before turning to our outlook for the coming year, let me take a moment to update you on two key cost savings initiatives, which involve optimizing our manufacturing footprint, and the streamlining of certain fixed and indirect ESG&A costs. Started in 2015 and 2016, respectively, taken together, these two initiatives are targeted to generate $30 million to $40 million in cost savings by the end of 2018.

On the manufacturing side, to date we have added two new facilities and closed six. The cost savings from the plant consolidations have contributed approximately $6 million of our expected $15 million to $20 million in annualized savings. We believe these optimization efforts will continue to increase manufacturing efficiency and lower costs by more effectively using resources and technology, improving plant processes, eliminating excess capacity, as well as better aligning production with market demand.

On our ESG&A initiative, we have restructured our commercial operations, consolidating certain activities where appropriate. While the absolute benefit of these activities is offset by increasing volumes and increased incentive compensation costs in 2016, we have realized approximately $6 million of our $15 million to $20 million target.

Now turning to our outlook for 2017. First, our capital expenditures for 2017 are anticipated to be in the range of $25 million to $30 million for the year, with some of the spending previously planned for 2016 landing in 2017, due to timing of payments.

In addition, we also see the opportunity to further enhance our manufacturing capabilities and efficiency, with some targeted investments that could range between $8 million and $10 million, and would be incremental to this expected range. We are evaluating these opportunities, and will only commit these additional funds if we believe there are compelling returns on the investment in a reasonable time frame.

With respect to our market outlook, based on our visibility so far, we believe that 2017 will show improvement over 2016, as a result of growth in volumes, and our ability to continue executing our operational improvement initiatives. Based on leading indicators, we currently expect mid single-digit, 3% to 6% underlying growth in low rise non-residential construction starts measured in square feet, and we expect to capitalize on the faster growth opportunities in insulated panels.

We ended the year with a consolidated backlog of $515.9 million, which is up 4% from a year ago, and is consistent with our growth expectations for 2017. We estimate steel costs will continue to be volatile, and increase on average from 2% to 9% over 2016 levels. As we have historically done, we expect to successfully pass steel price volatility through in our product pricing.

We will continue is executing our two cost saving initiatives for manufacturing and ESG&A, driving an incremental savings of $10 million in FY17 bringing our total cost initiative achievement to $22 million. Our long term target is to reduce our ESG&A cost to less than 16% of revenue on an annual basis, compared to our current level of 18% in 2016.

Based on these factors, we believe we will deliver another year of modest growth in underlying volumes with continued year-over-year operating margin expansion, although at a slower pace than realized in 2016, as we comp back against periods of larger margin growth. And we expect that we will have made key investments that will further accelerate our earnings growth in 2018 and beyond.

For FY17, we estimate that revenue will range between $1.75 billion and $1.85 billion, and adjusted EBITDA will range between $175 million and $205 million. We feel confident that we can build upon the success of the past year, and exceed its performance.

As has always been the case, revenues will be stronger in the second half of the fiscal year, given the peak construction periods during the Summer and Fall months. Conversely the first half is generally weaker and more volatile due to the usual seasonal factors of weather and business planning cycles affecting construction. And based on our current visibility, the first quarter 2017 will be weaker than last years first quarter due to the slowdown in bookings we experienced in both September and October as a result of the market hesitancy I mentioned earlier.

Further, key elements of our manufacturing cost reduction plans are being completed in the first quarter which, while very beneficial to the annual results, will likely create some near-term transitional inefficiencies and extra expense. For the first quarter, we estimate consolidated revenue will range between $370 million and $390 million, with gross margins ranging between 21% and 23.5%.

As a reminder, we have provided additional financial guidance for the first quarter in the supplemental presentation posted on our website. Now, I'd like to turn the call back over to Norm for his final thoughts on 2017.

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Thank you, Mark. So just a couple of final thoughts to wrap up. Low rise construction, five stories and less, is greater than 85% of all the annual new starts in non-residential construction. This market correlates almost perfectly with the actual economic growth in the US.

Through the non-residential market, NCI touches virtually all aspects of the economy. Over the last seven years, we have seen a historically weak economic recovery, and the low rise non-residential activity has yet to recover to reach average recessionary trough levels of the past 50 years.

During 2016, NCI has worked to restructure, to consolidate manufacturing facilities, supply chain operations, commercial activities. The impact of these actions has created operating leverage and driven earnings growth. We have proven on an annual basis that we can grow our top and bottom line dollars, even in a low growth economy, notably, regardless of whether material costs are going up or down. And when combined with our cost savings initiatives, the double digit growth opportunity we see in IMP, we believe we have created a great hand to play going forward.

Since the November election, there is optimism from the much needed renewal of a pro business focus on some of the traditional areas of growth, particularly in industrial, energy and manufacturing sectors. We believe that the increasing momentum from this focus on economic growth will provide our businesses and our products with opportunities to drive additional shareholder value in 2017 and beyond. Thank you, and we will now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Lee Jagoda with CJS Securities.

Lee Jagoda - *CJS Securities - Analyst*

So starting with the CENTRIA charge, Mark, can you give us a little more detail around that charge? And my perception is it would appear it has no real business impact the last year, let alone the quarter in which you took the charge.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

That's a fair assessment, Lee. The issue there is we characterized certain items that were on the opening balance sheet for CENTRIA, that were initially recorded as deferred revenue items, and upon applying purchase accounting, we would convert those into just remaining obligations without a revenue tail to them.

So we corrected that during the fourth quarter. It had an impact of reducing our revenue by about $1.8 million, which is indeed unrelated, really, to the operating activity during the fourth quarter. If you flow that down through the earnings per share calculation, that's approximately $0.02 impact during the period.

Lee Jagoda - *CJS Securities - Analyst*

To be clear, it also reduced your adjusted EBITDA by the same amount?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Yes, directly impacted EBITDA by the same amount.

Lee Jagoda - *CJS Securities - Analyst*

Okay, great and then Norm, turning to your guidance this is the first time that I can remember that you've been confident enough to give a full-year guidance at the beginning of the year. What gives you the confidence and visibility to give that guidance, and specifically, looking at the range, what are your assumptions for market growth and cost savings at both the bottom end and the top end of the range?

Norm Chambers - *NCI Building Systems, Inc. - CEO*

So when I think about it, I first start with what we have in line of sight. And at the end of November, our bookings were up 6%, and our backlog was up actually 9.8%. And what that tells me is that even though we know that the first quarter will start, because of the -- slowly, because of the softness we had before the election, that we're seeing activity.

And as Mark said, even through the period that people were not making decisions to go forward on jobs, the quoting activity was still really good. So my sense is that we will see this pick up, and while we won't get as much of it as I would like from the backlog in Q1, we have that chance to make that up in Q2.

So with the sense, and as you know, I've spoken about this before, that we really look at our first half and second half. So what we want to do is finish our first half no worse than flat, and it would be better to be up a little bit. But it's the second half of the year that I'm really encouraged by, and I see that from the numbers of jobs we're speaking to, the larger jobs, the sense of what's occurring.

When I look at our backlog, and when I look at our shipping and I see within the other category, I see what portion of that is expressed which is our building range for low complexity, that has really transformed our buildings group. And then when I look at the amount of infrastructure type of projects, I say we really are in good shape, and to take advantage of anything that results from a focus in the next administration on pro business. So that's the sense of it.

When I look and we think about our guidance, we think about it from a standpoint of how we developed it. It's ground up, it's bottom up, it goes through a lot of process of challenges. It goes through what strategic investment we wish to make, right?

And we do it in a very thoughtful way with contingency as well. It's the same approach we took in 2016. So from that standpoint, I have a high degree of confidence that we're going to do everything we can in our power to deliver the year we think we can.

Lee Jagoda - *CJS Securities - Analyst*

Okay and just to put some math around it, if I look at the $166 million of EBITDA you finished this year with, and you add back the $1.8 million and look at market growth of 3% to 6%, anywhere in that range, and give you credit for the $10 million of cost savings you'll expect to realize, I'm already well above the low end of your guidance range. So what I'm struggling with is, does the bottom end imply a market decline, and you are not seeing other operational leverage?

Norm Chambers - *NCI Building Systems, Inc. - CEO*

It's part of this notion of contingency, right? And what I mean by that is Lee, when we look at the unforced errors, when we look at the things that we could do better, it is clear to me that there is ample opportunity for us to have a hell of a year in 2017.

Lee Jagoda - *CJS Securities - Analyst*

Fair enough. Thanks very much.

Operator

Our next question comes from the line of Steven Fisher with UBS.

Steven Fisher - *UBS - Analyst*

Just in terms of cash flow, because you did have a headwind from working capital in FY16, wondering how you're thinking about the working capital items in FY17, and whether your free cash flow should be ahead of net income, in line, or below in FY17?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Sure, the only real issue that you saw towards the end of FY16 with the working capital was the increasing steel cost, and that drives up higher transactional values, because it's very seamlessly passed through to end-users of our product. So you get a higher transaction value in receivables, you get a higher transaction value in inventory, and an offsetting higher value in accounts payable. But the net does use working capital.

We do anticipate that steel costs will be increasing in 2017 over 2016 so that will cause more investment into working capital than otherwise would be the case, but it would be in the order of $10 million to $20 million in range.

Steven Fisher - *UBS - Analyst*

Okay, that's helpful. And just in terms of the cost savings, just curious what would have to happen in order for you to get the full $40 million by the end of FY18, because it would imply around $18 million of additional benefits just in the year of 2018. Do you have line of sight to that, or are you thinking you'd be more likely within the $30 million to $40 million range?

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Well, we have line of sight. We really, when it comes to this cost reduction stuff, it actually is a much more straightforward approach from the standpoint of, if you are taking manufacturing, what consolidations have we done, what does that mean?

When you look at some of the opportunities with ESG&A, it's the same thing. In other words there's a number of finite events. So when we look at that it's more the timing and doing it in a very thoughtful way.

So we've done a pretty good job to be on pace for where we expect to be, maybe a little ahead of pace. So my sense is that we have still some important things to do, but they are all things we'll be working on all through 2017 and into 2018.

Steven Fisher - *UBS - Analyst*

Thank you very much.

Operator

Our next question comes from the line of Bob Wetenhall with RBC Capital Markets.

Bob Wetenhall - *RBC Capital Markets - Analyst*

Thanks for wrapping up the year, Norm, with your outlook. It's encouraging.

Mark can you give us bridge for gross margin from Q1 2016 to Q1 2017 guidance? And I'm just trying to understand a little bit better how much of the step down is steel cost and how do you account for the rest of the decline? Really, just from a historical of Q1 2016 to Q1 2017.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Sure, Bob. So we expect to see some level of volume oriented operating leverage decline, relative to the slowness we've seen in incoming orders in the fourth quarter, that will flow over into the first quarter. One of the bigger things that we've got also occurring in the first quarter is some pretty big steps in our cost reduction plan for manufacturing, which we've taken a big step already in November. So we will have extra expense and transitional efficiency items that will occur as a result of that, that will all land in the first quarter. So that's really the reason for the step down in Q1.

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Bob, just to give a bit more on that. The growth we're seeing in insulated metal panels, particularly on the architectural side has really driven our manufacturing guys to look at ways that they can better align the equipment in one of our premier plants.

So part of what we're doing in the first quarter is taking that plant down, and reorganizing the equipment. And we've seen incredible growth in the intercept product, that plant produces. So it's something we said in the script will have a pay back in the year, and it really will, because that line will be back online by January.

Bob Wetenhall - *RBC Capital Markets - Analyst*

Right so back to the question, can you help step me through from the first quarter of 2016 to 2017? Because there's a lot of moving pieces, I'm really confused, I know that you're doing a lot of -- sounds like you're doing some stuff operationally to drive better performance, and that's incurring some temporary cost.

So you're getting -- you're having costs now, but at the same time you have a steel hit, and there's some stuff going on with volume. Can you disaggregate that, and give us like a little direction from a gross margin standpoint, just off the historical to Q1 2017? Because if I understand that, then I can get the rest of your 2017 guidance into context.

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Okay so the things that affect the margin expectation that the range that Mark has given you for Q1 directly results from probably 30% of that is volume related, as a result of the slowness that we saw in the fourth quarter of new projects, right? So that has affected our shipping schedules in Q1, which is reflected in our guidance.

Another 30% will be the manufacturing piece, right? Where we have plants that we have closed, a plant that we are reorganizing the equipment, and that has an impact on us, okay? And the remainder is probably more about mix and steel costs going through, which we're finishing up that higher cost steel.

Bob Wetenhall - *RBC Capital Markets - Analyst*

That's exactly what I was looking for. And then just if I could add-on to that or ask about that, you take a steel hit in Q1, do you get a rebound effect off your inventory, which is what's giving you confidence to make up lost ground on margin in second, third and fourth quarter? And is that why you're confident in the guidance?

Norm Chambers - *NCI Building Systems, Inc. - CEO*

The first of which, we are seeing a substantial resolve in our steel suppliers in putting their costs up, right? And you know for a long time I've been a proponent that for our industry to be in good shape, steel costs have to go up, because those suppliers have to be healthy, right? And I'm pleased to say that it looks like the environment is ripe for that to continue. That's a good environment for us, not a bad environment.

And the second thing is that when I look at the mix, we really have been developing a blend of mix that really suits us in terms of the opportunity to add value. When I look at the insulated metal panel portion of how many buildings we're shipping that have insulated metal panel, it's very,

very impressive. So when I put this altogether and then step back and try to, as you know, Bob, I have people around me to make is sure I'm cautious right? In this contingency, we get to a point where we like what we see.

Bob Wetenhall - *RBC Capital Markets - Analyst*

Good, well good luck, and thanks for the bridge to that. It's helpful to understand the trajectory and the internal initiatives to drive profitability, and I hope your optimistic view on the market manifests itself in the new environment. Thanks very much.

Operator

Your next question comes from the line of Scott Schrier with Citigroup.

Scott Schrier - *Citigroup - Analyst*

Can you talk about how you think about the margin hit that you're taking in coaters, which has had significant momentum recently to sell that internally, versus what you could be, what the margin could be if you sell the coaters externally, and also paint the IMP panels externally?

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Yes, so the ultimate opportunity is that we always do well from a margin perspective in the coating group, by having a portion of our production being internal, right? Now in the case of what we've been doing for the insulated metal panel part, particularly the metal spend, part of that is that we have been shifting our supply base and our painting approach. And to be sure, that created some problems for us, and we worked through those. It's more logistic and getting the team entirely integrated, in terms of how we go about that. And I would be lying to you when I say that the opportunity, in terms of fewer mistakes, it's real, right?

So at the end of the day, the team we have, both in commercial and manufacturing, are sorting that out. So I have no doubt that we will return to the margin in coating that we should return to. But I will say this, the advantage we have in our supply chain, the advantage we bring to our downstream businesses, is the ability to coat our steel and to change and to do short runs.

Even if it's slightly less effective for the coating group, it helps the downstream businesses be more responsive to their customers. So I'm not that sensitive to worrying about a few points of coating, because we can make it up in what we sell to third parties.

Scott Schrier - *Citigroup - Analyst*

Got it. And then as a follow-up, can you talk about the cyclicality of your business? I know that CENTRIA seems to take some of that out, and you also discussed in your prepared comments how some of the projects that you're bidding on are a little longer in nature. So can you talk about how the cyclicality of the business might trend?

Norm Chambers - *NCI Building Systems, Inc. - CEO*

So historically, we say that in a given year, our first two quarters are our slowest. Construction season is when we really move ahead, and that has been the case forever. But what's interesting is that we is have been able to show that we're slightly less affected by cycles, because of our ability to manufacture and supply chain, supply our materials in a way that buffers that a bit.

But to be sure of the insulated metal panels, we have in fact gained with the architectural. It gives us visibility of nine or more months in our backlog. We find that our buildings group still gives us visibility to have about six months, and the metal span piece on the cold storage gives us about four months. My point being that it's also the blend of that backlog that gives us the ability to manage our cyclicality.

Scott Schrier - *Citigroup - Analyst*

Got it. Thank you.

Operator

(Operator Instructions)

Our next question comes from the line of Trey Grooms with Stephens Inc.

Trey Grooms - *Stephens Inc. - Analyst*

Just a quick follow-up to Bob's question earlier on the margins. If we're looking past the first quarter, Mark, should we expect any additional strain on margins from your reorganization efforts and cost save initiatives, or by the time we get through Q1, will that largely be behind us? Just trying to think about how to model out the margins as we look on a quarterly basis going forward?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Sure. I would tell you that you should not expect net strain beyond the first quarter. That doesn't mean the activities stopped. The activities will continue, and there will be additional items that are occurring, but by that point, the net benefits will be outweighing those incremental items.

Trey Grooms - *Stephens Inc. - Analyst*

Okay, got it. And then as you look around geographically, obviously the energy markets have been tough for you, some of the ag markets have been tough for you. Are you seeing change in activity, especially around ag and energy?

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Yes, so what we are finding is that the Permian basin started to show growth. So after a couple or three years of negative growth, we saw some positive, that was up about 4%. We're definitely seeing from talking to people in the service industry in oil and gas, a pick up in requests, even an ability for some to start to put their prices up.

When I look across our business, I see that ag was up 34% in orders, right? When I look at the interesting thing, in our other category, we do a bunch of infrastructure work, which is like wastewater and things to do with that, in support of construction activities, facilities and what not.

When I look at the recreation side, we're really strong in recreation. We do a lot of work, that's up 34%. And then we're generally, we have, healthcare has been up for us, local government work has been up, warehousing has been up by 5%, hangars is up, so it's not great, but it is improving.

Trey Grooms - *Stephens Inc. - Analyst*

Okay, and with that, where are you seeing the weakness? You've got several areas that sound like they are looking up significantly. What areas are you still seeing weakness, as you look into your backlog?

Norm Chambers - *NCI Building Systems, Inc. - CEO*

We are still, we still are seeing a little bit of weakness in the Southeast. We're seeing New England continuing to be pretty reasonable. We're seeing that the Texas market and the South is really quite strong.

We are seeing that the -- starting to see a pick up in the industrial manufacturing side, as well, a little bit of light at the end of the tunnel. The West Coast has been quite strong for us. Canada has been weak, for sure.

Trey Grooms - *Stephens Inc. - Analyst*

Okay, and really just with the follow-up, just to make sure I was clear, you talked about some of the end markets that were driving some of the strength. I'm trying to get my hands around what, because you touch about every part of the economy as you said earlier in the call. And you noted areas of the economy where you're seeing strength. I'm trying to get my hands around more areas of the economy, things that you touch, where you are not seeing that relative strength, where things are still challenging.

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Well there's no question that when you think about all of the products we ship, particularly in the buildings group manufacturing is the biggest part of what we ship. And it still is, but it's down 50% in terms of the industry, right? This is a big deal, the industrial part. And this is in part why I believe that we have a hesitation in part, because of the policies and regulations that we've seen in the marketplace.

My sense is that we have half a chance of that improving. I will tell you that when I talk to people out in the industry, which I do all of the time, the level of optimism is like nothing I've seen post election at any time in my work history, and we can all imagine that's too much exuberance, but anything that could be positive in terms of the industrial recovery is a good thing.

Trey Grooms - *Stephens Inc. - Analyst*

Okay that's all helpful. Thanks a lot Norm, and good luck. Thanks a lot.

Operator

There are no further questions. That does conclude our Q&A session. At this time, I will turn it back to management for closing comments.

Norm Chambers - *NCI Building Systems, Inc. - CEO*

Thank you very much for joining us. We look forward to speaking to you in the next call, first quarter.

Operator

Ladies and gentlemen, thank you for your participation. This does conclude today's teleconference. You may disconnect your lines, and have a wonderful day.
